No. 8431

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

BISHOP TRUST COMPANY, LIMITED, et al.,
Trustees, MAUDE G. YOUNG TRUST,
Appellants,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Appellee.

On Petition for Review of Decision of the United States Board of Tax Appeals.

BRIEF FOR APPELLANTS.

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JURISDICTION.

This review involves income taxes against the Appellants amounting to $712.51 for the calendar year 1932 under the Revenue Act of 1932. The Memorandum Opinion (R. p. 33) and the Decision and Order of the Board of Tax Appeals affirming the deficiency determined and assessed by the Commissioner of Internal Revenue were entered on August 11, 1936. (R. p. 41.) Petition for a review of this determination was filed with the Court on November 9, 1936. (R. p. 42.) The jurisdiction of this Court is invoked under Sections 1001-1003 of the Revenue Act

of 1926, C. 27, 44 Stat. 109-110 as amended by Section 1101 of the Revenue Act of 1932, C. 209, 47 Stat. 286. The pertinent provisions of the statute involved are contained in Appendix A, infra, pages i-ii.

STATEMENT OF THE CASE.

This proceeding involves Federal Income Tax for the calendar year 1932 in the amount of $712.51. A deficiency of said amount was determined by the Commissioner of Internal Revenue and notice of said deficiency was given by letter dated March 11, 1935. (R. p. 13.)

The Appellants appealed to the Board of Tax Appeals from this determination on May 15, 1935, assigning as error the failure of the Commissioner to allow as an additional deduction from gross income, in accordance with the provisions of Section 162(b) of the Revenue Act of 1932, in the determination of the statutory net income of the Maude G. Young Trust for the calendar year 1932, $12,000.00 of income received by the Trust which was to be and in fact was distributed currently to the beneficiaries of the Trust during said year. (R. p. 5.)

The facts upon which the Appellants relied in support of their appeal were set forth in the "Stipulation of Facts" filed with the Board of Tax Appeals on January 13, 1936 (R. p. 18), which stipulation may be summarized as follows:

Maude G. Young, widow, died testate on October 3, 1926, a resident of Honolulu, Territory of Hawaii,

and was survived by two children, Alice Pauline Young MacRae and Nelson Gillett Young. (R. p. 19.) The Will of decedent (R. p. 24) was admitted to Probate in the Circuit Court of the First Judicial Circuit, Territory of Hawaii, and Letters Testamentary were issued on November 15, 1926, to Bishop Trust Company, Limited, and Arthur Berg as Executors. (R. p. 19.) On December 20, 1926, said Executors qualified as and were appointed Trustees under the Will of the Maude G. Young Trust. (R. p. 19.) On June 1, 1934, Arthur Berg, one of the co-trustees, died and Nelson Gillett Young was duly appointed successor co-trustee. (R. p. 20.)

The Will in brief provided that all debts, expenses and taxes, including taxes on all devises and bequests given, as well as certain cash legacies totaling $80,000.00 (of which $45,000.00 were to bear interest at the rate of six per cent (6%) from the time of death until payment (R. p. 25)) were to be paid out of the cash principal of the estate at the time of death and out of the proceeds of sale of bonds and real estate and surplus net income over the amount payable to the children of the Testatrix, without selling any of the corporate stocks. (R. p. 24.) In the event that the Executors could not complete all payments out of cash derived from such sources within a reasonable time, they were directed to turn over the residue of the property charged with the payment of said cash legacies (R. p. 24) and the Trustees were then to pay the cash legacies out of the surplus net income of the trust estate remaining after the payments to the children of the testatrix. (R. p. 25.) The residue of

the estate was given in trust to pay the sum of $500.00 a month to Alice Paulin Young MacRae, beginning as of the date of death and continuing until she and Nelson Gillett Young shall both have attained the age of 35 years or died, and to pay to Nelson Gillett Young $250.00 a month beginning as of the date of death and continuing until he shall have attained the age of 25 years or until his marriage or death, and thereafter, if surviving, to pay to him the sum of $500.00 a month until he and Alice Pauline Young MacRae shall both have attained the age of 35 years or died. (R. pp. 26-27.) When both Alice Pauline Young MacRae and Nelson Gillett Young shall have attained the age of 35 years or died there was to be transferred, free of trust, one-half of all the principal and accumulated income of the trust to Alice Pauline Young MacRae if then surviving, otherwise to her issue then surviving her, and in the absence of issue then to Nelson Gillett Young if then surviving, otherwise to his issue then surviving. (R. p. 27.) The other one-half of all of the principal and accumulated income was to go free of trust to Nelson Gillett Young if surviving, otherwise to his issue or in the absence of any issue surviving to Alice Pauline Young MacRae if surviving or to her issue then surviving. (R. p. 28.) In the event of the death of either before both had attained the age of 35 years, then the Trustees were to pay to the issue of that deceased child all the income which that child of the Testatrix would have been entitled to receive if he or she had survived until both children of the Testatrix had attained the age of 35 years. (R. p. 28.) In the event that both died without issue

prior to the distribution of the principal of the trust, the Will provided for the distribution of the principal to other persons. (R. pp. 29-30.)

The Trustees were authorized to use any income in excess of the payments directed to be made to the children for his or her benefit prior to the distribution of principal whenever, in the discretion of the Trustees, such additional income should be needed because of illness or for any other such cause or purpose. (R. p. 29.)

None of the beneficiaries could anticipate, alienate or assign his or her interest in the income or principal of the estate nor pledge or mortgage the same. (R. p. 30.) There were provisions that certain items were to be considered principal and others income, and it was provided that the income of the probate estate should, upon transfer to the Trustees, be considered by them as income rather than principal of the trust. (R. pp. 31-32.)

The accounts of the Executors were approved and Order of Discharge of the Executors made on April 16, 1928, and said Executors delivered to the Trustees in final distribution the residuary estate having an appraised value as of the time of death of $700,780.61, subject to cash legacies totaling $80,000.00. (R. pp. 20-21.) The appraised value of all the assets which could be sold to pay the legacies and bequests was $92,382.64 composed as follows:

King and Victoria Streets property	$75,000.00
Pacific Heights Lot No. 9	4,382.64
Leasehold—Papaakoko	8,000.00
Stamps, miscellaneous collection	5,000.00
	$92,382.64

Pursuant to the terms of the Will of the Testatrix, the Trustees have made monthly payments of the sums specified therein to her children, such payments being made as of a time commencing with the date of death, and continuing to the present time. (R. p. 21.) The books of account and records of the Trustees have been kept on a cash receipts and disbursements basis at all times and their Federal income tax returns have been filed on the same basis. (R. p. 22.) During the calendar year 1932 the statutory income and deductions (not including whatever deductions may be allowable under provisions of Section 162(b) of the Revenue Act of 1932 on account of payments made to the beneficiaries) of the Maude G. Young Trust were of an amount as follows:

Gross Income:		
Interest	$ 784.80	
Rent	1,631.42	
Dividends (Domestic)	25,263.02	$27,679.24
Deductions:		
Taxes	1,443.76	
Other deductions	1,885.29	3,329.05
The net income prior to the application of Section 162(b) (R. p. 22)		$24,350.19

Neither Nelson Gillett Young nor Alice Pauline Young MacRae had attained the age of 35 years on or before December 31, 1931 and, in accordance with the Will of the Testatrix, the Trustees made distributions to the aforesaid *cestuis que* trust during the calendar year 1932 as follows:

*Alice Pauline Young MacRae	$ 6,000.00
*Nelson Gillett Young	6,000.00
	$12,000.00

(R. pp. 22-23.)

The Trustees, in their return, claimed a deduction under the provisions of Section 162(b) of the Revenue Act of 1932 of the $12,000.00 distributed to the *cestuis que* trust as aforesaid. (R. p. 23.) The Commissioner disallowed the claimed deduction and determined a deficiency for the amount of tax in question. (R. p. 23.) Upon appeal the Board of Tax Appeals entered its Memorandum Opinion thereon August 11, 1936, and its final Order and Decision August 11, 1936, that there is a deficiency of $712.51 for the year 1932. (R. pp. 33-41.) On November 9, 1936, the Appellants petitioned this Court for a review of this determination. (R. pp. 42-49.)

QUESTIONS INVOLVED.

The sole issue on appeal is whether the Appellants may, in the determination of the statutory net income of the Maude G. Young Trust, under the provisions

*Twelve monthly payments of $500.00 each.

of Section 162(b) of the Revenue Act of 1932, deduct $12,000.00 of income received by the Trust and actually distributed to beneficiaries in accordance with the requirements of the Will during said year. The determination of this issue depends upon the answer to the following questions:

(1) Does the Will direct the Trustees to pay to the son and daughter mentioned therein a sum certain out of income or principal or does it direct that the payments be made from income and income alone?

(2) Assuming *arguendo* that the Will does direct the Trustees to make monthly payments to the son and daughter out of income or principal, does the Will nevertheless direct the distribution of income currently?

(3) Assuming *arguendo* that the Will does direct the Trustees to make monthly payments out of income or principal, if there are no assets comprising principal which could be availed of in making the payments so that all payments in fact would have to be out of income, would such payments constitute amounts of income which are to be distributed currently within the meaning of Section 162(b) of the Revenue Act of 1932.

SPECIFICATION OF ASSIGNED ERRORS RELIED ON.

The Appellants rely upon the following assigned errors of the United States Board of Tax Appeals:

(1) The failure to allow as a deduction from the Petitioners' gross income for the calendar

year 1932 the sum of $12,000.00 paid by the Petitioners to the Testatrix's son and daughter as aforesaid (R. p. 47);

(2) The failure to find that the sum of $12,000.00 paid by the Petitioners to the Testatrix's son and daughter as aforesaid in 1932 was paid entirely out of income of the said trust estate (R. p. 47);

(3) The failure to find that the sum of $500.00 a month payable to each of the Testatrix's son and daughter under said Will was payable out of income only and that no part of said sum was payable out of principal of said trust estate (R. p. 48);

(4) The failure to find that the sum of $500.00 provided by said Will to be paid to Testatrix's son and daughter each month was not payable in any event (R. p. 48);

(5) The finding and holding that the said Will directed the Trustees to pay to the son and daughter mentioned therein, a sum certain in any event (R. p. 48);

(6) The finding and holding that Petitioners are not entitled to take as an additional deduction in the taxable year the sum of $12,000.00, so paid out as aforesaid (R. p. 48);

(7) The finding and holding that construing said Will as a whole the intention of the Testatrix was not to require all payments by the Trustees to be made from income (R. p. 48);

(8) The finding of a deficiency of $712.51 for the year 1932 in lieu of a determination that there is no additional income tax due from Petitioners for the year in controversy. (R. p. 48.)

ARGUMENT.

Assignment of Errors.

(3) The failure to find that the sum of $500.00 a month payable to each of the Testatrix's son and daughter under said Will was payable out of income only and that no part of said sum was payable out of principal of said trust estate (R. p. 48);

(4) The failure to find that the sum of $500.00 provided by said Will to be paid to Testatrix's son and daughter each month was not payable in any event (R. p. 48);

(5) The finding and holding that the said Will directed the Trustees to pay to the son and daughter mentioned therein, a sum certain in any event (R. p. 48);

(7) The finding and holding that construing said Will as a whole the intention of the Testatrix was not to require all payments by the Trustees to be made from income. (R. p. 48.)

I.

THE WILL DOES NOT DIRECT THE TRUSTEES TO PAY TO THE SON AND DAUGHTER MENTIONED THEREIN A SUM CERTAIN OUT OF INCOME OR PRINCIPAL, BUT DIRECTS THAT THE PAYMENTS BE MADE FROM INCOME AND INCOME ALONE.

Section 162(b) of the Revenue Act of 1932 reads as follows:

> "There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries. * * * but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. * * *"

It is clear that if the payments to the son and daughter are directed to be made from income and income alone, then the deduction of such payments in the determination of the statutory net income of the trust must be allowed under the provisions of Section 162(b) of the Revenue Act of 1932 and this is fully conceded by the Government. The Appellants contend that the Will directs the payments to be made from income and income alone and in support of its contention urges the following:

> (A) There is no express provision in the Will of Maude Gillett Young that monthly payments of $500.00 to each of the beneficiaries are to be made out of the corpus of the estate, or are to be paid in any event.

(B) In the absence of the specific designation in the Will of the Testatrix of the source of the monthly payments, the intention of the Testatrix must govern.

(C) The intention of the Testatrix must be ascertained from a construction of the Will as a whole.

(D) The construction of the whole Will discloses that the Testatrix intended that the monthly payments to her children should be made only from income.

(E) The construction of the whole Will discloses that the Testatrix intended to keep the corpus of the trust fund intact until the termination of the trust and not to have the payments to her children constitute a charge against corpus.

(F) The corpus of the trust was sufficiently large to indicate to the Testatrix that the income would be more than sufficient from which to make the monthly payments to the children.

(A) There is no express provision in the Will of Maude Gillett Young that monthly payments of $500.00 to each of the beneficiaries are to be made out of the corpus of the estate, or are to be paid in any event.

There is nowhere in the Will any express direction that payments to the son and daughter of the Testatrix are to be made out of corpus or are to be paid in any event regardless of the amount of income available for such payments.

The NINTH paragraph of the Testatrix's Will (R. pp. 26-27) governs the monthly payments to the beneficiaries, and makes no reference to the source from which the payments are to be made. Subparagraphs (a) and (b) read as follows:

> "(a) To pay to my daughter, Alice Pauline Young MacRae, wife of Herbert Bennett MacRae, the sum of Five Hundred Dollars ($500.00) each and every month in advance on the first day of the month, beginning as of the date of my death and making the first payment as soon as possible after my death, until she and my son, Nelson Gillett Young, shall both have attained the age of thirty-five (35) years or died;
>
> "(b) To pay to my son, Nelson Gillett Young, the sum of Two Hundred Fifty Dollars ($250.00) each and every month in advance on the first day of the month, beginning as of the date of my death and making the first payment as soon as possible after my death, until he shall attain the age of twenty-five (25) years or until his marriage or death, whichever event shall happen first, and thereafter to pay to him, if surviving, the sum of Five Hundred Dollars ($500.00) each and every month in advance on the first day of the month until he and my daughter, Alice Pauline Young MacRae, shall both have attained the age of thirty-five (35) years or died."

Although no provision is made in the foregoing subparagraphs with reference to the source from which the payments are to be made, all through the Will, as will be shown, every time any reference is made to the payments therein provided, such payments are referred to as payments out of income and when

all of these provisions are considered together there can be no doubt but that the Testatrix intended these payments to be made out of income.

(B) In the absence of the specific designation in the Will of the Testatrix of the source of the monthly payments, the intention of the Testatrix must govern.

There can be no dispute with the rule set out by the United States Supreme Court in *Smith v. Bell,* 6 Peters 68, 75, 8 L. Ed. 322, 325, to the effect that in the exposition of wills the intention of the testator expressed in his will shall prevail, which intention is to be collected from the words of the will.

Relative to regular monthly payments directed to be made to beneficiaries, it is stated in 2 R. C. L. 8, that:

> "It is often difficult to determine whether an annuity is to be paid out of the capital of an estate or only out of the income. The question must be determined by *ascertaining the intention* of the testator, and each case will depend upon the meaning of the words used by him. *Wilce v. Van Anden,* 24 Ill. 358, 94 N. E. 42 (quoting from *Einbecker v. Einbecker,* 162 Ill. 267, 273)."*

To the same effect is 2 Page on Wills 1702, as follows:

> "Where it is doubtful whether testator intended to make a gift of income, or to create an annuity, the *question is one of his intention,* to be determined usually by finding from the will whether the gift was to be paid out of the principal in any event, or only the income of the principal was to pass. Dewey's Estate, 46 N. E. 1039."

*Italics throughout the brief are counsel's unless otherwise indicated.

(C) The intention of the Testatrix must be ascertained from a construction of the Will as a whole.

It is well settled that in the construction of a Will, the whole Will is to be taken together, and so construed as to give effect, if possible, to the whole.

In *Colton v. Colton,* 127 U. S. 130, 32 L. Ed. 138, the Supreme Court said:

> "The object, therefore, of a judicial interpretation of a will is to ascertain the intention of the testator, according to the meaning of the words he has used, *deduced from a consideration of the whole instrument* and a comparison of its various parts in the light of the situation and circumstances which surrounded the testator when the instrument was framed."

To the same effect is 4 Paul & Mertens, Law of Federal Income Taxation 64, as follows:

> "In construing trust instruments, reliance will be placed in part on well-established principles of interpretation * * * The provisions of an instrument are to be *construed as a whole* to give effect to each and every one, if possible, without undue emphasis upon any single provision."

(D) The construction of the whole will discloses that the Testatrix intended that the monthly payments to her children should be made only from income.

It is well established that the right to succeed to the property of the decedent depends on and is regulated by State law, and the judicial construction of the Will by a State court of competent jurisdiction determines

the extent and character of the interests taken by the legatee.

Uterhart v. U. S., 240 U. S. 597, 60 L. Ed. 819;
Knowlton v. Moore, 178 U. S. 41, 57, 44 L. Ed. 969, 976;
Fidelity & Columbia Trust Co. v. Lucas, 66 Fed. (2d) 116 (CCA 6).

A diligent search discloses no Hawaiian decisions construing a will exactly similar to the one here in question. In the absence of such decision, under the provisions of Section 1, R. L. of Hawaii, 1935, the common law rule is applicable. The United States rule is stated in 2 R. C. L. 8 as follows:

> "In the United States * * * the trend of judicial opinion seems to be that the corpus will not be charged with an annuity, unless the intention of the testator so to charge clearly appears."

The Appellants contend that since there is no expression by the Testatrix of an intention to charge the monthly payments on the principal, the payments can be made from income and income alone.

But even more, the Appellants contend that the construction of the Will as a whole clearly discloses that the intention of the Testatrix was to have the monthly payments made from income alone. Throughout the Will there is an express recognition by the Testatrix of the separate character of principal and income and evidence of a clear intention on her part to differentiate between principal and income in their distribution. Stock dividends are to be treated as principal and not income. (R. p. 31.) All income received by

the Trustees from the Executors is to be treated as income in the hands of the Trustees. The contract rate of interest on bonds, without deduction or addition for discount or premium if purchased or sold below or above par is to be considered the income of the trust thereon (R. p. 32) and the Trustees are empowered to determine in what proportion assessments, taxes, etc. shall be borne between capital and income, every such determination to be conclusive on all parties interested. (R. p. 31.) The Testatrix clearly made these provisions, separating principal and income for a purpose. Inasmuch as her children were to receive the principal upon distribution as well as the payments during the continuance of the trust, all the careful provisions dealing with the separation of income and principal would have been meaningless unless the Will is construed to mean that income and income only could be paid out prior to the time when the express provisions for the distribution of corpus became applicable. An examination of specific provisions of the Will make this intention to have the payments made from income alone clearly evident.

It is therefore necessary that we analyze the following specific provisions of the Will:

In paragraph First of the Will of Maude Gillett Young (R. p. 24), it is provided:

> "I direct my Executors to pay all my just debts and funeral and administration expenses and also all estate, inheritance, succession and transfer taxes on all devises and bequests given hereby and also the cash legacies given hereby, out of the cash principal of my estate at the time of my death

> and the proceeds of sales of my bonds and real estate and *the surplus net income over the amount payable to my daughter and son as hereinafter provided,* without selling any of my corporation stocks. If my Executors shall not be able to complete all said payments out of cash derived from said sources within a reasonable time I authorize my Executors to complete the administration of my estate and to transfer and deliver the residue of my property as hereinafter provided to my Trustees hereinafter named, charged with the payment of said cash legacies, and I authorize my said Trustees to accept said residue so charged with said cash legacies and to pay the same out of the surplus net income of my trust estate."

In the First paragraph of the Will reference is made to the payments provided to be made to the son and daughter of the Testatrix. Those payments are referred to as being payable out of net income. It is provided that if the cash legacies could not be made from the cash principal at death and the proceeds of the sale of all property except stocks, then such legacies were to be paid from any surplus *net income over the amounts payable to the son and daughter.* Clearly this means that the net income of the trust was to be used first for payments to the son and daughter, and then if any remained such income might be used to pay all cash legacies which could not otherwise be paid from the principal of the estate without selling the corporate stock which is prohibited by another paragraph of the Will. (R. pp. 27-28.)

It is clear that "the amount payable to my daughter and son as hereinafter provided" refers to the pay-

ments directed to be made to them by Paragraph NINTH (a) and (b) and it will be noted that those payments are here referred to as being payments of net income. When this provision is read together with paragraph NINTH (a) and (b) there can be no doubt but that the Testatrix intended and directed that those payments be made out of income and income alone.

Paragraph NINTH (c) of the Will reads as follows:

> "When my daughter, Alice Pauline MacRae, and my son, Nelson Gillet Young, shall both have attained the age of thirty-five (35) years or died, to transfer, convey and deliver in fee simple, free from any trust, one-half (½) of *all the principal and accumulated income* of the trust estate to my said daughter if she shall be then surviving or if she shall not be then surviving, to her issue then surviving or if there shall be none of her issue then surviving to my said son if he shall be then surviving, or if he shall not be then surviving to his issue then surviving, and one-half (½) of *all the principal and accumulated income* of the said trust estate to my said son if he shall be then surviving and if he shall not be then surviving to his issue then surviving or if there shall be none of his issue then surviving, to my said daughter if she shall be then surviving or if she shall not be then surviving to her issue then surviving;"

In the above quoted paragraph, it is provided that upon termination of the trust *all of the principal* and accumulated income of the trust is to be transferred, conveyed and delivered in fee simple. In the construction of a gift for a limited period the disposition of the remainder is important in indicating the con-

struction that is to be put on intermediate gifts. (See Annotation at L. R. A. 1917 E. 581.) Here the gift of remainder in plain terms embraces *"all of the principal"*. There is no ambiguity or room for doubt about the meaning of that expression. It does not mean the "balance of the principal" or some equivalent term, nor does it leave room for any construction embracing less than all of the principal. To say that the term *"all of the principal"* means the balance of the principal after payments to the children or that such principal may be drawn on for such payments if income is insufficient is to ascribe a meaning to plain and unambiguous words that is unwarranted by anything in the Will itself or to circumstances surrounding the creation of the trust therein.

Considering paragraph NINTH (c) together with (a) and (b) there can be no doubt but that the Testatrix intended the payments provided therein to be made from income alone and the entire principal undiminished by any payments to be distributed at the termination of the trust.

Paragraph NINTH (d) of the Will (R. p. 28) provides:

> "If my said daughter shall die before my said son leaving issue surviving her then my Trustees shall pay said issue *all the income which she would have been entitled to receive* if she had continued to survive until the death of my son at the same times and under the same conditions. If she shall die before my son without leaving issue surviving her or if she shall die before my son leaving issue surviving her but said issue shall all

> die before the death of my son, my Trustees shall thereafter pay to my son *all the income which my daughter would have been entitled to receive* if she had continued to survive until his death and at the same time and under the same conditions;"

Provision is here made that in the event of the death of Testatrix's daughter *all the income which she would have been entitled to receive* had she survived until the time for the distribution of the principal arrived, shall be paid to her issue and if she left no issue surviving then such *income* shall go to Testatrix's son. The use of the word "income" throughout clearly indicates the intention of Testatrix. Nothing is said of annuities or monthly payments which the said daughter of the Testatrix was entitled to receive. Rather, the payments are referred to as of income. The only gift of income to the said daughter (except as to surplus income above the monthly payments, provided in paragraph NINTH (f) discussed, infra) is that given in paragraph NINTH (a) and (b), quoted supra. Clearly the income referred to in paragraph NINTH (d) is that provided in paragraphs (a) and (b) and the use of the term "income" referring to that gift clearly indicates that the Testatrix considered and intended that gift to be one of income and income alone.

Paragraph NINTH (e) of the Will (R. pp. 28-29) provides:

> "If my said son shall die before my said daughter leaving issue surviving him then my Trustee shall pay said issue *all the income which he would have been entitled to receive* if he had continued

> to survive until the death of my daughter and at the same times and under the same conditions. If he shall die before my daughter without leaving issue surviving him or if he shall die before my daughter leaving issue surviving him but said issue shall all die before the death of my daughter, my Trustees shall thereafter pay to my daughter *all the income which my son would have been entitled to receive* if he had continued to survive until her death and at the *same time and under the same conditions;*"

The repetition of the same provisions in equivalent terms relative to the payment of the income that the son is entitled to, in the event of his death, indicates again the intention to have the payments made from income and income alone.

Paragraph NINTH (f) of the Will (R. p. 29) reads:

> "I hereby authorize my Trustees to pay to my daughter or son or to use and apply for her or his benefit prior to the distribution of the principal, *portions of the income or accumulated income derived from the trust estate in addition to the amounts hereinabove set forth* if and whenever in their discretion *such additional income* shall be needed by her or him because of illness or for any other special cause or purpose. * * *"

It should be noted that it is provided that even in the event of necessity because of illness or other special cause or purpose the children can only receive from the Trustees *portions of the income or accumulated income* derived from the trust estate. To say that the testatrix intended the monthly payments to be made at all events and out of the corpus in the face

of such a limitation to income in the case of actual necessity for illness, etc., is to construe the Will in a most contorted manner. If the Testatrix intended principal ever to be used, it is more reasonable to suppose that she would have permitted it to be used in case of illness or necessity. When it cannot be used even in such cases, it is unreasonable to suppose that the Testatrix intended principal to be used for the regular payments. The intent is clear that the income and only the income, even in the event of necessity was to be paid to the children prior to the time the express provisions of the Will as to the distribution of corpus became applicable.

Paragraph NINTH (g) of the Will (R. pp. 29-30) reads as follows:

> "If my daughter and son shall both die prior to the distribution of the principal of my trust estate and if there shall be no issue of my children surviving, to transfer, convey and deliver *all of the principal and accumulated income* of said trust estate in fee simple, free from any trust as follows:
>
> "Three-fourths (¾) to those who would have been the heirs of my late husband, Archibald Alfred Young, if he had then died intestate and domiciled in the Territory of Hawaii and in the same proportions, and one-fourth (¼) to those who would have been my heirs if I had then died intestate and domiciled in the Territory of Hawaii and in the same proportions;"

Again the gift of the remainder in the event of the death of the children before the termination of the trust embraces *all the principal* and accumulated in-

the Testatrix not to have the principal impaired but to pass in its entirety free of all charges.

Paragraph NINTH (f) of the Will, quoted supra, provides that even in the event the Trustees determine the necessity for additional amounts for the children, such paymnts can be made *out of income alone.* Clearly if the principal cannot be impaired in case of necessity, the original amounts were not intended to be allowed to impair the principal either, since the additional amounts are indicated to be payable from the surplus income after the payments to the children.

Paragraph NINTH (g) of the Will, quoted supra, provides that upon the death of both children before reaching the age of 35 years without leaving children *all of the principal* and accumulated income of said trust shall be transferred, etc. Such clear language in reference to the subject matter of the remainder interest indicates the intention to preserve the principal intact.

Paragraph NINTH (h) of the Will (R. p. 30) reads as follows:

> "None of the beneficiaries of my trust estate shall have the right or power in any way to anticipate, alienate or assign his or her interest in the income or the principal of my said trust estate or to use his or her interest in the said income or principal as collateral security for a loan or pledge or mortgage the same in any manner, and I direct my Trustees not to recognize or give any force or effect to any such anticipation, alienation, assignment, pledge or mortgage; and I direct my

> Trustees to make payment directly to the said beneficiaries, free from the control of any husband or wife and free from the interference or control of the creditors of any beneficiary;"

The creation of spendthrift provisions shows that the Testatrix had in mind as a major purpose the preservation of the principal of the estate until her children reached an age at which she believed they would be able to manage it. That she did not desire the children to have too much money, or be in a position where they might waste or dissipate the estate, is clearly indicated by the whole plan of the trust. This intention is strengthened by the fact that even in the event of necessity the children might receive, at the discretion of the Trustees, additional sums, but *only out of income.* (R. p. 29.) It should be noted as further bearing on this major intention of the Testatrix that additional payments of income are to be made at the discretion of the Trustees when they believe such additional amounts are needed, because of illness or other special cause or purpose. This too is consistent with the prime purpose of the Testatrix to preserve the principal intact until the children are old enough to manage it themselves, which purpose is not to be defeated in any event. Even the determination that there exists a necessity for additional sums is left to the Trustees, not to the children, but in no event, even in case of necessity, may the principal be impaired.

All through the Will the Testatrix makes separate provisions for the handling and disposing of principal and income. And all through the Will there is manifest the intent to keep the principal intact and undiminished by any charge of any kind.

(F) The corpus of the trust was sufficiently large to indicate to the Testatrix that the income would be more than sufficient from which to make the monthly payments to the children.

At the time of the execution of the Will, the estate of the Testatrix was a large one, and the monthly payments provided for in the Will were very small as compared to the income which her properties were earning at that time.

Not only is it logical to assume that the Testatrix was fully cognizant of the approximate amount of income from her various investments and the due dates thereof, because she had been receiving the income therefrom for several years, but she had every reason to anticipate that an insufficiency of income for the payments to her children was hardly likely.

Accordingly, when she set aside her "corporation stock" as the corpus of the trust, and provided that said stock should not be sold, she was confident that the income therefrom would be ample to meet the provisions of the trust without encroaching upon the principal.

In *Hartford-Connecticut Trust Co. v. Eaton,* 36 Fed. (2) 710, (CCA2) by Will there was bequeathed to the Trustee an estate of over $1,000,000.00, to pay the income to Testator's wife during her life, with re-

mainder to charity. Power was given to the Trustee to pay to the wife any part of the principal deemed necessary for her comfortable maintenance and support. The Trustee sold some securities and realized a profit which profit was a part of the principal. The question was whether this should have been returned as part of the income taxable to the widow accruing during her life or was free of tax as income set aside for charitable uses. The Court held, relying on *Ithaca Trust Co. v. U. S.,* 279 U. S. 151, 73 L. Ed. 647, that the plaintiff would never find it necessary to use the corpus for her support since the income was enough for that support according to her habit and therefore that the profit going to the principal of the trust which she had the right to draw on was nevertheless not taxable income to the widow.

In the *Ithaca Trust Co.* case, supra, a trust was set up for Testator's wife for life with authority to use from principal any sum that may be necessary suitably to maintain her in as much comfort as she then enjoyed, with gifts of remainder to charity. The Court, in allowing the deduction of the charitable gifts, said that the income at the death of the Testator and even after the payment of debts and legacies, was more than sufficient to maintain the widow as required, and that there was no uncertainty appreciably greater than the general uncertainty that attends human affairs, that the gift to charity would be defeated by reason of her right to draw on the principal. To the same effect is *Lucas v. Mercantile Trust Co.,* 43 Fed. (2) 39, (CAA8), and *First National Bank v.*

Snead, 24 Fed. (2) 186, (CAA5), in which cases the Court took into consideration the value of the estate and the income of the estate, among other things, as indicating the improbability of the invasion of the principal of the trust in the event income should be insufficient.

Again, in *Hartford-Connecticut Trust Co. v. Eaton,* 41 Fed. (2) 69, (D. C. Conn.), a trust was created providing for the payment of $5000.00 per year to Testator's wife from income, balance to charity. The trust estate had a value of over $1,000,000.00 and income ranging from $70,000.00 to $120,000.00 per year. The question arose as to whether profit on the sale of securities was deductible as permanently set aside for charitable purposes. The Court said:

> "While there is an infinitesimal possibility that the corpus of this trust may have to answer to this annuity at some future time, it must be borne in mind that * * * for that year and every year since there have been ample means to insure the payment from income * * * it does not seem that the income to them should be defeated where, as in the present case there is no human probability that a situation could arise where the corpus of the estate would be invaded to pay the annuity."

And in *Millard v. Humphrey,* 8 Fed. Sup. 784 (D. C. N. Y.), where the estate was $455,180.41, and the necessary payments about $10,000.00 per year, the Court took into consideration the fact that it was hardly likely that properly invested such an estate

would not return an income substantially in excess of $10,000.00.

In all these cases the Court took into consideration the fact that although a fund might be drawn on under the provisions of the Will in question, nevertheless because the income in each case was so great considering the amount required for the payments directed, for tax purposes, the Will was in effect to be construed as if the Will did not permit drawing on the principal.

In the case at bar the size of the estate and the income derived therefrom, as well as the specific language of the Will, makes it absolutely certain that the intention of the Testatrix was to have the payments made from income and from income alone.

Summary of provisions of Will showing intent of Testatrix to preserve the corpus intact and to have the payments to her children made from income:

1. The direction that if the legacies could not be paid from the assets without selling the stocks they were to be paid from *surplus net income.*

2. The reference to such surplus net income as the *income remaining after the payments* to the children of the Testatrix.

3. The provisions distributing *all* the principal of the trust at its termination or sooner upon certain contingencies.

4. The reference to the payments as being *income* which the children were entitled to receive.

5. The provisions limiting the discretion of the Trustees in making additional payments when necessary for illness or other cause, to payments of *income.*

6. The provisions of the Will prohibiting alienation, etc.

II.

ASSUMING ARGUENDO THAT THE WILL DOES DIRECT THE TRUSTEES TO MAKE THE MONTHLY PAYMENTS TO SAID SON AND DAUGHTER OUT OF INCOME OR PRINCIPAL, THE WILL NEVERTHELESS DIRECTS THAT INCOME BE DISTRIBUTED CURRENTLY.

The Appellants contend that even assuming arguendo that the Will permits principal to be used in making payments to the children, that nevertheless income is directed to be distributed currently, at least to the extent that there is income.

In support of its contention Appellants urge the following:

(A) Where the source from which the payments are to be made is not expressed in the Will such payments must be made from the income to the extent that such income exists.

(B) To the extent that income exists and is directed to be paid out, it constitutes income of the trust which is to be distributed currently to the beneficiaries.

(C) Even though principal may be drawn upon if the income is insufficient to make the pay-

ments, such fact does not operate to alter the fact that income is directed to be distributed currently to the extent that it exists.

(A) Where the source from which the payments are to be made is not expressed in the Will such payments must be made from the income to the extent that such income exists.

Regardless of whether the monthly payments are a charge on corpus or not, in any event, the charge is one on income primarily and to the extent that income exists, it must be used to make the payments.

> "The very nature of an annuity suggests that, when those charged with the payment of it have in their hands a fund producing income sufficient to pay it, the payment should be made from the income, and not from the principal." 3 C. J. 212, Sec. 27; 3 C. J. S. 1381, Sec. 5.

In *Hammond v. Hammond,* 169 Mass. 82; 47 N. E. 535, a bill was brought for instructions as to whether certain legacies were to be paid out of the income or out of the principal. By codicil the Testator had reduced each of the legacies to his children and to his grandchild so that the aggregate amount payable to them was $5500.00 instead of $10,000.00. Each was to receive a stated sum payable at the decease of the Testator, and the same sum annually for the four years next succeeding. In the original Will nothing was said in regard to the source from which these payments were to be made. In the codicil he made a provision as follows:

> "And I also will that the aforesaid four payments after my decease shall be made semi-annual,

and payable as near the middle of January and July during the four years aforesaid as shall be most convenient to my said executors; *and after such payments, if there shall be left a balance from my semi-annual incomes,* the same shall be paid to my wife, Ellen M. Hammond, in addition to the five hundred dollars aforesaid bequeathed to her."

The Court in holding that the payments are to be made from income rather than principal, said:

"If the original will stood alone, it would not be clear whether the income, or a part of it, would be applicable to the payment of these annuities. Nothing being stated in regard to the source from which these payments should be made, it might be held that they would be taken from the principal, and that the entire income of the estate after first reserving enough to pay these annuities and the legacies payable at the decease of the testator, would be paid to the widow * * *. By the codicil the wife is to be paid from the testator's semi-annual incomes only the balance, if any, after the payment of these annuities. * * *

Even if there were no express provision in regard to payment the *division of the legacies to each of his children into five equal parts, one to be paid in each year, would be an indication that they were to be paid from income, rather than from the principal of his estate.* In *Cummings v. Cummings,* 146 Mass. 501; 16 N. E. 401, it was said that 'the very nature of an annuity suggests, when those charged with the payment of it have in their hands a fund producing income sufficient to pay it, that the payment should be made from

the income, and not from the principal'. See also *Treadwell v. Cordis,* 5 Gray 341-351. A majority of the court are of the opinion that the four payments to the sons and grandsons should be made out of the income if that is sufficient."

(B) To the extent that income exists and is directed to be paid out it constitutes income of the trust which is to be distributed currently to the beneficiaries.

In its opinion below, the Board of Tax Appeals based its holding on its finding that Sections (a) and (b) of the NINTH paragraph of the Will, clearly direct the Trustees to pay to the son and daughter mentioned therein a sum certain in any event and cited *Helvering v. Pardee,* 290 U. S. 365; 78 L. Ed. 365, and *Burnett v. Whitehouse,* 283 U. S. 148; 75 L. Ed. 916, as authority. (R. p. 40.)

In *Helvering v. Pardee,* supra, the Will provided in part as follows:

> "Third. I also give unto my said wife an annuity of * * * $50,000.00 to be computed from the date of my decease and to be paid in advance in quarterly payments. * * *
>
> Ninth. All the rest, residue and remainder of my property, real and personal * * * I give, devise and bequeath absolutely and in fee simple unto the Girard Trust Company and its successors, to my brother * * * and son * * * IN TRUST NEVERTHELESS, to collect the rents, income, profits and dividends thereof, and after payment of the expenses of the trust, to my said wife the annuity of $50,000.00, which I have hereinbefore given to her." (Quoted from the reported case, 23 L. T. A. 846, 847.)

The Court held in effect that since the Will did not direct the source from which the annuity was to be paid, the payment could be made from either corpus or income and the mere accident that it happened to be paid from one source or the other should not control the taxability of the payments. The Will, however, in that case was far different from the Will of Maude G. Young, in the case at bar. In the first case, the payments in the *Pardee* case were referred to as an "annuity". That term itself is used in distinction to the term "income" which has an entirely different meaning.

> " 'Income' is distinguished from 'annuity' in that 'income' means profits to be earned, the amount of which is not fixed or certain, but is contingent upon the amount of earnings, whereas an 'annuity' is a fixed amount directed to be paid absolutely and without contingency. * * * In the case of annuities where the income is insufficient, the Executors or Trustees may encroach upon the principal, even in the absence of a specific direction, while in the instance of a real or expressed trust the Trustees are not permitted to pay out any portion of the principal unless the Will specifically so authorizes." 3 C. J. S. 1374, Section 1B1.

The term "annuity" is a technical legal term with a definite precise meaning.

> "Technical terms when used in a will should be given their technical meaning and legal effect unless from subsequent inconsistent words or from the whole will it is very clear that the testator meant otherwise, in which case the words will be

construed so as to effectuate such intention." Thompson on Wills, (2d Ed.) 294, Section 226.

In the *Pardee* case the Court was obliged to hold that in the absence of the showing of another intent, the annuity provided for was an annuity according to the legal meaning of that term and was therefore payable either out of corpus or income, and therefore the direction of the testator to pay the annuity was not a direction to distribute income of the trust.

In the second place, in the *Pardee* case the will did not show any intention to have the annuity paid out of income. In the present case, as shown above, every provision of the will in which any reference is made to the payments directed to be made to the children, refers to such payments as payable out of net income, and the whole scheme of the Will as well indicates very strongly that that was the intention of the Testatrix.

Again, in the present case, as distinguished from the *Pardee* case, there was a prohibition against selling the stocks which were the only assets comprising the principal and it was therefore impossible for the principal of the trust to provide funds to make up the deficiency of income if any to make the required monthly payments. It is not a case of the Trustees being given a choice of funds out of which to make the payments so that the fact that payments are made from income is a mere accident as in the *Pardee* case, but rather in the case at bar there is only one source available for the payments and that source is income.

In the *Whitehouse* case, supra, cited by the Board of Tax Appeals in its opinion below, the question was whether amounts received as an annuity were taxable to the recipient as income or were free of tax as gifts or legacies under the provisions of Section 22(b)-3 of the Revenue Act of 1932 providing that "the value of property acquired by gift, bequest, devise or inheritance" shall not be included in gross income. In holding that the recipient was not taxable on such receipt, it was said that even though income was used in making the payments they were not gifts to be derived from and paid out of income according to the direction of the Testator.

The *Whitehouse* case concerned a tax on the recipient of the amounts paid out of a trust estate and that decision does not and cannot control the present case. In the present case the provision to be construed is Section 162(b) and the deductibility by the Trustee of its payments is not to be determined by ascertaining whether the receipt of such income is taxable to the recipients. If the amounts paid meet the test of deductibility set forth in Section 162(b), viz.: that they constitute amounts of income to be distributed currently by the Trustee, such amounts must be allowed as deductions to the Trustees, and the taxability to the recipient follows therefrom, under the express wording of the Statute.

Section 162(b) provides that where income of a trust paid to beneficiaries is allowable as a deduction in computing the taxable income of the trust, such

amounts of income shall be taxable to the beneficiaries thereof.

The test is not the taxability to the beneficiary. That follows from the deductibility to the trust, and the test of that deductibility is the direction in the instrument creating the trust that income be distributed currently.

(C) Even though principal may be drawn upon if the income is insufficient to make the payments such fact does not operate to alter the fact that income is directed to be distributed currently to the extent that it exists.

Appellants contend that the mere fact that principal may be called on if income is insufficient to meet the payments does not alter the fact that income is directed to be distributed currently to the extent that it exists. It is clear that if the Will provided in express terms that all of the income of the trust was to be distributed to designated persons there would be no question but that all such income would be deductible in computing the statutory net income of the trust. An additional provision to the effect that if such income were less than $500.00 per month such deficiency could be paid out of the principal does not alter the fact that all the income that exists is directed to be distributed currently and therefore such distribution qualifies under Section 162(b) as an allowable deduction of the trust. This would be true even in the absence of the special conditions which exist in the present case, namely, that except for the most unexpected contingency, the income would never be less than sufficient to meet the payments and also that

there existed (as will be clearly shown) no principal out of which any deficiency of income could be made under the provisions of the Will. Where, even in the absence of express provisions of the Will, the Will must, as a matter of law, be construed to require the payments out of income to the extent that it exists, then for purpose of the tax statute, this is the same as though a specific provision therefor was included in the Will. Section 162(b) is not limited in its application to cases where income is to be distributed currently under *express provision of an instrument,* but it is applicable to cases where, as a matter of law, such distribution out of income is required. It is clear, as shown above, that to the extent that income exists such income must be used to make the payments to the children, and to the extent that such income exists and must be paid out, it is income which is directed to be currently distributed and is therefore deductible under Section 162(b).

Assignment of Errors.

(1) The failure to allow as a deduction from the Petitioners' gross income for the calendar year 1932 the sum of $12,000.00 paid by the Petitioners to the Testatrix's son and daughter as aforesaid. (R. p. 47.)

(2) The failure to find that the sum of $12,000.00 paid by the Petitioners to the Testatrix's son and daughter as aforesaid in 1932 was paid entirely out of income of the said trust estate. (R. p. 47.)

(6) The finding and holding that Petitioners are not entitled to take as an additional deduction in the

taxable year the sum of $12,000.00, so paid out as aforesaid. (R. p. 48.)

(8) The finding of a deficiency of $712.51 for the year 1932, in lieu of a determination that there is no additional income tax due from Petitioners for the year in controversy. (R. p. 48.)

III.

ASSUMING ARGUENDO THAT THE WILL DOES DIRECT THE TRUSTEES TO MAKE THE MONTHLY PAYMENTS OUT OF INCOME OR PRINCIPAL, IF THERE ARE NO ASSETS COMPRISING PRINCIPAL WHICH COULD BE AVAILED OF IN MAKING THE PAYMENTS SO THAT ALL PAYMENTS IN FACT WOULD HAVE TO BE OUT OF INCOME, SUCH PAYMENTS WOULD NECESSARILY CONSTITUTE INCOME WHICH WAS TO BE DISTRIBUTED CURRENTLY, WITHIN THE MEANING OF SECTION 162(b) OF THE REVENUE ACT OF 1932.

The Appellants contend that payments from any source but income were impossible. Accordingly, any payments directed to be made would have to be from income and the payments would therefore be amounts of income to be distributed currently.

In support thereof Appellants contend as follows:

(A) There were no assets comprising principal available for the payments to the children except corporate stocks.

(B) Under the Will, corporate stocks could not be sold during the existence of the trust.

(C) The income of the trust for the calendar year 1932 was more than sufficient from which to make the monthly payments to the children of the Testatrix.

(D) The monthly payments to the children of the Decedent during the calendar year 1932 were made in fact out of the income of the trust for said calendar year 1932.

(A) There were no assets comprising principal available for the payments to the children except corporate stocks.

Paragraph FIRST of the Will, quoted supra, provides that, in the event the Executors could not raise sufficient cash from the sale of all assets except the stocks, the residue was to be transferred to the Trustees charged with the unpaid legacies which were, however, payable only out of surplus accumulated income remaining after the payment of the amounts payable monthly to the children. (R. pp. 24-25.)

The Trustees, in fact, did receive the residue of the estate of the Testatrix charged with unpaid cash legacies, totaling $80,000.00, which legacies were bequeathed in the THIRD to EIGHTH paragraphs, inclusive, of the Testatrix's Will. (R. pp. 25-26.) The real and personal property which could be sold (all except the corporate stocks) had been appraised at $92,382.64, as follows:

Real Property:	
King and Victoria Streets	$75,000.00
Pacific Heights Lot	4,382.64
Personal Property:	
Leasehold, Papaakoko	8,000.00
Stamp Collection	5,000.00
	$92,382.64

(R. p. 21.)

If all the property, that the Testatrix authorized to be sold, could have been sold, it is probable that little more than sufficient to pay the $80,000.00 of legacies would have been realized. It is fairly inferable from the Executors' failure to sell the real and personal property and to pay the $80,000.00 that said properties were not marketable at or near their appraised values. The fact that three of the legacies of $15,000.00 each were payable with interest at 6% from the time of Testatrix's death, and accordingly subjected the estate to an annual interest charge of $2700.00, adds weight to this inference. If the property could have been sold promptly at or near the amount necessary to pay the legacies, the interest saving would have been inducement enough to the Executors to sell the property in the year and a half before they turned the property over to the Trustees charged with the payment of the legacies.

(B) Under the Will, corporate stocks could not be sold during the existence of the trust.

Paragraph First of the Will, quoted supra, forbid the sale of corporate stocks, even to pay the legacies.

In *Queen's Hospital v. Cartwright,* 19 Haw. 52, by her Will, Queen Emma had bequeathed to defendants for their respective lives certain designated sums per annum, "such annuities to be paid by my said Trustee or his successors in regular monthly payments". Upon the death of the annuitants, the Trustees were empowered to sell any real estate, free of any trust, provided the real estate remaining could, in the opinion of the Supreme Court, produce a yearly income sufficient to provide for certain scholarships provided

for. An action was brought prior to the death of all the annuitants for a decree ordering the Trustee to transfer to the residuary legatee such property held for the payment of the annuities in excess of that required to produce sufficient income for the annuities outstanding. The defendants demurred on the ground that the Trustee was required by the Will to retain all the trust property until the death of all the annuitants and could not safely or prudently deliver over to the plaintiff any part of the corpus of the trust fund.

The court said:

> "If the Trustee could sell this land and should buy U. S. bonds with the proceeds—at present rates $93,600.—would buy 2% registered bonds yielding an income of $1,800.—the amount of the outstanding annuities—the annuities would be fully secured. But this course would not only be of doubtful value to the hospital—*it would nullify the direction of the Testatrix that the lands be held by the Trustee.*"

For the same reason, namely, that it would nullify the direction of the Testatrix, the stocks, which would be the only source from which the monthly payments might otherwise be paid, if the income were insufficient, could not be sold to make up a deficiency of income. Such a course would nullify the direction of the Testatrix that the stocks be not sold. So that even if the contention claimed by the Government to the effect that the monthly payments were to be made in any event, was upheld, such payments could not actually be made in the absence of income, since there would be no principal available which could be used to pay them.

(C) The income of the trust for the calendar year 1932 was more than sufficient from which to make the monthly payments to the children of the Testatrix.

During the calendar year 1932, the statutory income and deductions (not including whatever deduction may be allowable under the provisions of Section 162(b) of the Revenue Act of 1932 on account of payments made to beneficiaries) of the Maude Gillett Young Trust, were as follows:

Gross Income:		
Interest	$ 784.80	
Rent	1,631.42	
Dividends (domestic)	25,263.02	$27,679.24
Deductions:		
Taxes	1,443.76	
Other deductions	1,885.29	3,329.05
Net Income prior to the application of Section 162(b)		$24,350.19

(R. p. 22.)

The *net income* of the Trust for the said year was more than adequate to make the distributions ($12,000.00) to the *cestuis que* trust of the specified amounts in conformity with the provisions of the Trust.

(D) The monthly payments to the children of the decedent during the calendar year 1932 were made in fact out of the income of the trust for said calendar year 1932.

Pursuant to the provisions of the Trust, the Trustees made distributions to the *cestuis que* trust during the calendar year 1932 as follows:

Alice Pauline Young MacRae.....$6,000.00
Nelson Gillett Young..... 6,000.00
12 monthly payments of $500.00 each. (R. p. 23.)

The Trustees deducted said $12,000.00 from the gross income of the trust as income to be distributed currently to said beneficiaries, and voluntarily paid a tax on the "undistributed net income of the trust". (R. p. 23.)

CONCLUSION.

Only one objection to the respondent's findings was taken by Petitioners, namely, his denial of the additional deduction authorized by Section 162(b) of the Revenue Act of 1932; the amount is $12,000.00. It has been demonstrated herein that the Petitioners were justified by the facts and the statute in claiming the additional deduction of $12,000.00 and that the respondent erred in denying said additional deduction in redetermining the Petitioners' taxable net income for 1932, and therefore the determination of the Board of Tax Appeals should be reversed.

Dated, Honolulu, T. H.,
March 29, 1937.

Respectfully submitted,
SMITH, WILD, BEEBE & CADES,
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(Appendix Follows.)

Appendix.

Appendix A

REVENUE ACT OF 1932, c. 209, 47 Stat. 286.

Sec. 11. *Normal Tax on Individuals.*

There shall be levied, collected, and paid for each taxable year upon the net income of every individual a normal tax. * * *

Sec. 12. *Surtax on Individuals.*

There shall be levied, collected, and paid for each taxable year upon the net income of every individual a surtax as follows: * * *

Sec. 21. *Net Income.*

"Net income" means the gross income computed under Section 22, less the deductions allowed by Section 23.

Sec. 22. *Gross Income.*

(a) *General Definition.*—"Gross income" included gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

(b) *Exclusions from Gross Income.*—The following items shall not be included in gross income and shall be exempt from taxation under this title. * * *

(3) *Gifts, bequests, and devises.* The value of property acquired by gift, bequest, devise, or inheritance (but the income from such property shall be included in gross income).

Sec. 162. *Net Income.*

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that * * *

(b) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, and the amount of the income collected by a guardian of an infant which is to be held or distributed as the court may direct, but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. Any amount allowed as a deduction under this paragraph shall not be allowed as a deduction under subsection (c) of this Section in the same or any suceeding taxable year; * * *

REVENUE ACT OF 1932, c. 209, 47 Stat. 286 amending Revenue Act of 1926, c. 27, 44 Stat. 109.

Sec. 1101. (a) The decision of the Board rendered after the enactment of this Act (except as provided in subdivision (j) of Section 283 and in subdivision (h) of Section 318) may be reviewed by a Circuit Court of Appeals, or the Court of Appeals of the District of Columbia, as hereinafter provided, if a petition for such review is filed by either the Commissioner or the taxpayer within three months after the decision is rendered.